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514929—43——1

In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 743

READING COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 3a–20a) is unreported. The opinion of the Circuit Court of Appeals (R. 170–177) is reported at 132 F. 2d 306.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on October 23, 1942 (R. 177–178). A petition for rehearing was denied on November 19, 1942 (R. 189). The petition for a writ of certiorari was filed on February 16, 1943.

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Taxpayer in 1933, 1934 and 1935 made loans aggregating $2,805,000 to the Pennsylvania-Reading Seashore Lines. The Board of Tax Appeals found that although the taxpayer charged off these debts in 1936, they had in fact become worthless, and taxpayer had ascertained them to be worthless, prior to 1936. The Circuit Court of Appeals held that the findings were supported by substantial evidence and affirmed the Board. Is the taxpayer entitled to a bad debt deduction in 1936 under Section 23 (k) of the Revenue Act of 1936?

STATUTE INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (k) *Bad debts.*—Debts ascertained to be worthless and charged off within the taxable year * * *

STATEMENT

Prior to June 24, 1933, the Pennsylvania Railroad Company and the taxpayer each owned a con-

trolling interest in a subsidiary railway company operating in southern New Jersey. Pennsylvania's subsidiary was the West Jersey and Seashore Railroad Company; taxpayer's subsidiary was the Atlantic City Railway Company (R. 3a–4a).

The operations of both lines were unprofitable. The combined losses amounted to $1,582,054 in 1932 (R. 5a).

The two lines served practically the same seashore resorts with similar schedules. In 1927 a report was submitted by officers of the proprietary companies recommending unification. It culminated on November 23, 1932, in a unification agreement approved by the Interstate Commerce Commission on June 10, 1933 (R. 5a, 6a).

Under this agreement the taxpayer transferred two-thirds of the Atlantic stock to Pennsylvania and Pennsylvania assigned its lease of West Jersey to Atlantic. All funded debt of Atlantic was cancelled with the exception of $4,500,000 par value of bonds. The taxpayer agreed to cancel all Atlantic indebtedness to it for advances, and Pennsylvania agreed to cancel certain specified amounts owed it by West Jersey. Reading and Pennsylvania agreed that in the event of the inability of the consolidated company to pay its operating expenses that they would advance the necessary sums which would bear interest at an agreed rate. The advances were to be made on

the basis of stock ownership, which was one-third by Reading and two-thirds by Pennsylvania. On July 15, 1933, the name of the consolidated company was changed to Pennsylvania-Reading Seashore Lines (hereafter sometimes referred to as "Seashore") (R. 5a–6a).

A consulting engineering firm, reporting its investigation of the proposed unification to the New Jersey Board of Public Utility Commissioners said that it would reduce operating expenses by approximately $1,700,000 and that capital requirements for the immediate future would be reduced by approximately $8,000,000. The Interstate Commerce Commission in *Unification of Lines in Southern New Jersey,* 193 I. C. C. 183, 188, stated that the estimated savings as a result of the consolidation was a total of $1,612,211, "an amount slightly in excess of the 1932 net income deficit of the two roads" (R. 7a).

The unification resulted in substantial savings in taxes, labor, and maintenance (R. 11a), and the operating efficiency of Seashore improved from 1934 through 1937 and 1939 (R. 12a). Despite the attainment of the anticipated reduction of operating expenses and the increased operating efficiency, Seashore had a net loss of $1,473,954 from June 25 to December 31, 1933; $2,812,838 in 1934; $2,623,044 in 1935; $2,152,694 in 1936; and $2,651,350 in 1937 (R. 9a). During this period

Seashore requested and obtained advances from the taxpayer and Pennsylvania as follows (R. 9a):

	Taxpayer	Pennsylvania
June 25 to December 31, 1933	$250,000	$500,000
1934	1,615,000	3,230,000
1935	940,000	1,880,000
1936	765,000	1,530,000
1937	753,000	1,507,333
	4,323,667	8,647,333

Reporting to the stockholders concerning the period July 1 to December 31, 1933, the board of directors stated (R. 10a):

> As a result of the low level of industrial activity which prevailed during the year and the continued competition of highway transportation, the revenues on these lines declined and despite the economies effected through unification the results were very unsatisfactory. * * * With the complete unification of train service, the abandonment of duplicate lines, and the prospect of a somewhat larger volume of traffic during the year 1934, it is anticipated that the results will be better, but it is quite apparent the savings resulting from unification must be supplemented by a substantial increase in the freight and passenger traffic moving over these lines if satisfactory financial results are to be realized.

The 1934, 1935 and 1937 annual reports of Seashore continued to attribute the operating deficits to low levels of gross revenues, increasing competition with highway transportation and increas-

ing costs due to wages, price of materials, etc. The 1936 report said (R. 10a–11a):

> It is apparent, therefore, that the economies effected through unification must be supplemented by a substantial increase in freight and passenger traffic moving over these lines if satisfactory financial results are to be realized.

Seashore's gross operating revenue for 1934 was 89.4% of 1932; in 1935 it was 85.1%; 1936, 98.9%; 1937, 96.1%; 1938, 81.4%, and 1939, 88.9%. This is to be contrasted with the total operating revenues of Class 1 railways of the United States particularly in the Eastern District, which increased steadily from 1932 through 1937 (R. 11a).

Prior to 1933, there had been competition from truck and bus lines and passenger automobiles. Freight and passenger traffic was being diverted to highway transportation (R. 8a). After unification in 1933, this diversion of railroad traffic to highway transportation continued (R. 12a).

In southern New Jersey in January 1933, 19 different bus companies served territory tributary to Atlantic and West Jersey lines operating on 58 different routes. Ninety-one truck companies operated on 113 different routes. In the seven counties in southern New Jersey served by Atlantic and West Jersey, hard-surfaced and improved highways increased 911 miles in 1931 over 1923 (R. 8a). In the period following unifi-

cation in 1933, hard-surfaced highways extended to every community of any size served by Seashore (R. 12a). Almost every community of a thousand population or more where Seashore had a station was served by one or more bus lines with scheduled trips, and by truck lines operating from New York and Philadelphia (R. 13a).

Seashore had a corporate surplus in 1933 of $3,975,309; in 1934 this had decreased to $2,565,198, and in 1935 the company had a deficit of $464,993. This deficit increased to $7,543,449 in 1936 and to $10,656,503 in 1937 (R. 11a).

In 1936 the taxpayer charged off its books as uncollectible the advances made from June 1933 to the end of 1935 (R. 60a). The Board of Tax Appeals found that the advances made by the taxpayer to Seashore from 1933 through 1935 were ascertained to be worthless before 1936 (R. 13a). Accordingly, the deduction claimed was disallowed (R. 18a). The Circuit Court of Appeals affirmed (R. 170–177).

ARGUMENT

The holding of the court below, contrary to the taxpayer's contention (Pet. 7), is not in conflict with *Rosenthal* v. *Helvering,* 124 F. 2d 474 (C. C. A. 2d). That case prescribed a "subjective" standard in determining whether a debt has been "ascertained" to be worthless. Under this standard as explained by the Second Circuit, the taxpayer is relieved of any "duty of general vigi-

lance" to make an inquiry into the facts (p. 477). But it cannot refuse to use the facts it has (p. 476). The "taxpayer has the burden of proving a negative—i. e. he must show that he did not 'ascertain' the debt to have been 'worthless' before the year in question," and the fact that a prudent man would have ascertained the worthlessness prior to the taxable year is evidence that the taxpayer did so (p. 476).

Although the court in the instant case stated that it preferred the "objective" test (pursuant to which a bad debt deduction is disallowed if "the taxpayer knew or ought to have known its worthlessness in a prior year," *Avery* v. *Commissioner,* 22 F. 2d 6, 8 (C. C. A. 5th)), it expressly held that under either standard, "the findings of the Board fully warranted its conclusion that the advances made by the petitioner to Seashore in 1933, 1934 and 1935 'were ascertained to be worthless before 1936' " (R. 174–175). It is plain that the court below was correct in its view that the finding was justified even on the basis of the standard of the *Rosenthal* case. The Board found that the advances had been ascertained to be worthless before 1936, thus meeting that requirement of that case. Since no question is raised here as to the taxpayer's knowledge of all the relevant facts prior to 1936, it was a reasonable inference that the taxpayer recognized from those facts the worthlessness of the debts. There can be little doubt on this record that a reasonable man would

reach this conclusion and that, as the court said in the *Rosenthal* case, is evidence that the taxpayer did so. Finally, the taxpayer did not sustain the burden recognized by the *Rosenthal* case of proving that it had not ascertained the debt to be worthless prior to 1936.[1]

The only question in the case, therefore, is whether there was substantial evidence to support the Board's finding that the taxpayer had ascertained the debt to be worthless prior to the taxable year. The decision is in accord with the familiar rules governing the finality of determinations by the Board of Tax Appeals on issues of fact. *E. g., Wilmington Trust Co.* v. *Helvering,* 316 U. S. 164.

Nor is the decision in conflict with *Capitol-Barg Dry Cleaning Co.* v. *Commissioner,* 131 F. 2d 712 (C. C. A. 6th), in that the Board here reached a conclusion at variance with that of the taxpayer's expert witnesses as to the worthlessness of the debts prior to 1936. The Sixth Circuit did not, and had no intention to overrule its prior decisions in accord with *Dayton P. & L. Co.* v. *Commission,* 292 U. S. 290, 298–299, holding that opinions of experts have no conclusive weight where there is other evidence to support the findings of the trier of fact. *First National Bank* v.

[1] Contrary to taxpayer's position (Pet. 6), neither the *Rosenthal* case, *Rassieur* v. *Commissioner*, 129 F. 2d 820 (C. C. A. 8th), nor the decision of the court below express conflicting views concerning any requirement that the year in which the debt became bad must coincide with the year in which the debt was ascertained to be worthless.

Commissioner, 125 F. 2d 157 (C. C. A. 6th); *Tracy* v. *Commissioner,* 53 F. 2d 575 (C. C. A. 6th), certiorari denied, 287 U. S. 632; *Grand Rapids Store Equipment Corp.* v. *Commissioner,* 59 F. 2d 914 (C. C. A. 6th). It expressly held in the *Capitol-Barg* case that the evidence considered in the aggregate was not sufficient to support the Board's finding. The opinion leaves no doubt that the expert testimony was only one factor in the conclusion that there was not substantial evidence. Indeed, the court concluded that (p. 715), "Every case must stand upon its own peculiar facts and circumstances * * *." In the instant case, however, the opinion of the experts was contrary to all the other evidence, and the court below properly concluded that the findings were supported by substantial evidence.

CONCLUSION

The case was correctly decided by the court below, and there is no conflict of decisions. The petition should be denied.

Respectfully submitted.

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